

**Letter of Findings Number: 03-20110262**  
**Withholding Tax**  
**For the Years 2008 and 2009**

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**ISSUE**

**I. Withholding Tax – Independent Contractors.**

**Authority:** IC § 6-3-4-8; IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Longmire v. Indiana Dep't of State Revenue, 638 N.E.2d 894 (Ind. Tax Ct. 1994); GKN Co. v. Magness, 744 N.E.2d 397 (Ind. 2001); IRS Publication 15-A (2011); 41 Am. Jur. 2d Independent Contractors §1 (2009); Income Tax Information Bulletin 52 (August 2008); Black's Law Dictionary (8<sup>th</sup> ed. 2004).

Taxpayer protests the imposition of withholding tax.

**STATEMENT OF FACTS**

Taxpayer, an Indiana company, offers "around the clock" "in-vehicle automotive testing" in a real environment "on public access roads." Taxpayer's customers are manufacturers who manufacture certain vehicles or equipment ("Equipment") required to be tested to comply with either industry standards or statutory/regulatory requirements. The customers provide Taxpayer the Equipment to be tested, pursuant to their service agreements, with certain specifications. The customers' specifications include time of day, routes, road conditions, weather conditions, and speed, etc.

Taxpayer only accepted applicants/individuals who have valid commercial driver's licenses ("CDLs"). Taxpayer then hired qualified individuals ("Drivers") after it completed a series of extensive background checks and tests. Upon hiring, at the orientation, Taxpayer provided Drivers general instructions, including Wishlist/Schedule, Drivers Reports/Fuel Logs, Information Board (such as shifts and routes), rules of operating Equipment, as well as insurance, route, and pay information. Drivers could select their shifts, but Taxpayer did not guarantee the availability of Equipment for Drivers. Before the selected shifts began, Drivers arrived at Taxpayer's facility where Equipment is stored and where Taxpayer assigned Equipment to Drivers on a "first come, first serve" basis. Taxpayer also provided Drivers with detailed instructions on how Drivers should operate Equipment to perform the required tests. Taxpayer further supplied each Driver with a credit card for expenses, such as purchasing gas/fuel on the road, during the test periods.

Pursuant to an audit, the Indiana Department of Revenue ("Department") found that Drivers hired by Taxpayer to operate Equipment were Taxpayer's employees. The Department determined that Taxpayer misclassified Drivers as independent contractors and did not withhold state and county income taxes and remit to the Department. As a result, the Department reclassified Drivers as Taxpayer's employees and assessed additional tax with regard to Drivers.

Taxpayer protested the Department's reclassification. An administrative hearing was held during which Taxpayer's representatives explained the basis of the protest. This Letter of Findings results. Further facts will be supplied as required.

**I. Withholding Tax – Independent Contractors.**

**DISCUSSION**

The Department's audit determined that Drivers were Taxpayer's employees because Taxpayer had (1) behavioral control, (2) financial control, and (3) employee-employer relationship with respect to Drivers. The Department's audit further found that Taxpayer misclassified Drivers as independent contractors and did not withhold state and county income taxes with regard to Drivers. Taxpayer, to the contrary, claimed that it properly classified Drivers as independent contractors and, therefore, it was not required to withhold state and county income taxes.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dept of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

IC § 6-3-4-8 states:

(a) Except as provided in subsection (d), **every employer making payments of wages subject to tax under this article, regardless of the place where such payment is made, who is required under the provisions of the Internal Revenue Code to withhold, collect, and pay over income tax on wages paid by such employer to such employee, shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in withholding instructions issued by the department.** The department shall base its withholding instructions on the adjusted gross income tax rate for persons, on the total rates of any income taxes that the taxpayer is subject to under [IC 6-3.5](#), and on the total amount of

exclusions the taxpayer is entitled to under [IC 6-3-1-3.5\(a\)\(3\)](#) and [IC 6-3-1-3.5\(a\)\(4\)](#). However, the withholding instructions on the adjusted gross income of a nonresident alien (as defined in Section 7701 of the Internal Revenue Code) are to be based on applying not more than one (1) withholding exclusion, regardless of the total number of exclusions that [IC 6-3-1-3.5\(a\)\(3\)](#) and [IC 6-3-1-3.5\(a\)\(4\)](#) permit the taxpayer to apply on the taxpayer's final return for the taxable year. Such employer making payments of any wages:

- (1) shall be liable to the state of Indiana for the payment of the tax required to be deducted and withheld under this section and shall not be liable to any individual for the amount deducted from the individual's wages and paid over in compliance or intended compliance with this section; and
- (2) shall make return of and payment to the department monthly of the amount of tax which under this article and [IC 6-3.5](#) the employer is required to withhold. (**Emphasis added**).

IC § 6-3-4-8(g) also provides:

The provisions of [IC 6-8.1](#) relating to additions to tax in case of delinquency and penalties shall apply to employers subject to the provisions of this section, and for these purposes any amount deducted or required to be deducted and remitted to the department under this section shall be considered to be the tax of the employer, and with respect to such amount the employer shall be considered the taxpayer. In the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest.

Accordingly, an employer is also required to withhold Indiana state and county income taxes pursuant to the above mentioned statute, which piggybacks the requirement to withhold for federal tax purposes. That is, when an employer is required to withhold federal income tax for an individual because that individual is an employee of the employer – defined either by common law or by statute – the employer is also required to withhold Indiana state and county income taxes for that individual as well (provided that the wages are subject to Indiana income tax). Since Drivers, in this instance, do not fall into the categories of employees defined by statute, the following discussion focuses on whether Drivers were Taxpayer's employees defined by common law.

"Employer" is defined as "[a] person who controls and directs a worker under an express or implied contract of hire and who pays the worker's salary or wages." Black's Law Dictionary 565 (8<sup>th</sup> ed. 2004). "Employee" is defined as "[a] person who works in the service of another person (the employer) under an express or implied contract of hire, under which the employer has the right to control the details of work performance." Id. at 564. "Independent contractor" is defined as "[o]ne who is entrusted to undertake a specific project but who is left free to do the assigned work and to choose the method for accomplishing it." Id. at 785. According to the American Jurisprudence, an "independent contractor is one who, in exercising an independent employment, contracts to do certain work according to his or her own methods, without being subject to the control of the employer, except as to the product or result of the work." 41 Am. Jur. 2d Independent Contractors §1 (2009). Behavioral and financial controls are the crucial factors in determining whether an employer-employee relationship exists. An employer-employee relationship "exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished." Longmire v. Indiana Dep't of State Revenue, 638 N.E.2d 894, 897 (Ind. Tax Ct. 1994).

The Internal Revenue Service ("IRS"), in its Publication 15-A, in relevant part, states:

To determine whether an individual is an employee or an independent contractor under the common law, the relationship of the worker and the business must be examined. In any employee-independent contractor determination, all information that provides **evidence of the degree of control and the degree of independence** must be considered. (**Emphasis added**).

The IRS illustrates that "facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties." The IRS further provides factors to be considered, in relevant part, as follows:

**Behavioral control.** Facts that show whether the business has a right to direct and control how the worker does the task for which worker is hired include the type and degree of:

**Instructions that the business gives to the worker.** An employee is generally subject to the business' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work.

- When and where to do the work.
- What tools or equipment to use.
- What workers to hire or to assist with the work.
- Where to purchase supplies and services.
- What work must be performed by a specified individual.
- What order or sequence to follow.

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task

may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

**Training that the business gives to the worker.** An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

**Financial Control.** Facts that show whether the business has a right to control the business aspects of the worker's job include:

**The extent to which the worker has unreimbursed business expenses.** Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services that they perform for their employer.

**The extent of the worker's investment.** An independent contractor often has a significant investment in the facilities or tools he or she uses in performing services for someone else. However, a significant investment is not necessary for independent contractor status.

**The extent to which the worker makes his or her services available to the relevant market.** An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

**How the business pays the worker.** An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is often paid a flat fee or on a time and materials basis for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

**The extent to which the worker can realize a profit or loss.** An independent contractor can make a profit or loss.

**Type of relationship of the parties.** Facts that show the parties' type of relationship include:

- **Written contracts describing the relationship the parties intended to create.**
- **Whether or not the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.**
- **The permanency of the relationship.** If you engage a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this generally considered evidence that you intent was to create an employer-employee relationship.
- **The extent to which services performed by the worker are a key aspect of the regular business of the company.** If a worker provides services that are a key aspect of your regular business activity, it is more likely that you will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship. **(Emphasis in original).**

The above factors may not all apply to a particular situation; nonetheless, factors are applied when relevant.

In this instance, Taxpayer argued that it did not have behavioral control because Drivers were required to follow the customers' instructions. Taxpayer stated that its customers "defined the conditions of testing, including the routes to be driven and the procedures Taxpayer was to use in the data gathering process." Additionally, Taxpayer argued that it did not have financial control because its customers supplied the Equipment "equipped with data cab recorders which transmit data directly from the vehicles to its customers." Thus, Taxpayer asserted that it simply provided opportunities to individuals who were qualified and available to operate Equipment. Taxpayer further argued that it did not maintain employer-employee relationship with Drivers because many Drivers had full-time employment somewhere else and Drivers acknowledged, in writing, that they were independent contractors receiving payments either by hour or by mileage they drove. Thus, Taxpayer claimed that it correctly classified Drivers as independent contractors.

To support its protest, Taxpayer submitted additional documentation, including an affidavit and a sample contract between Taxpayer and one of its customers, as well as sample agreements between Taxpayer and some Drivers. Taxpayer also provided a package, which its customers provided Taxpayer defining the testing projects, included samples of Statement of Work, work orders, test plans, routes and maps, as well as Taxpayer's invoices to its customers. Additionally, Taxpayer provided documentation contained its detailed instructions to Drivers including Taxpayer's own "Test Plans," "Daily Driver Report," "Fuel and Fluids Logs," "Comments," "Daily Trip Log," "New Driver Orientation Checklist," "Driver Wishlist," and "Drivers Schedule."

Upon reviewing Taxpayer's documentation, the Department must respectfully disagree with Taxpayer's assertion that Drivers were independent contractors. As mentioned above, Taxpayer is a service provider, offering "around the clock" and "in-vehicle automotive testing" in a real environment "on public access roads" to its customers. Essentially, Taxpayer's business – testing services – is to test drive or operate its customers' Equipment to determine the performance of Equipment. Taxpayer promised to deliver certain results to its customers and its customers signed the contracts with Taxpayer, including Taxpayer "shall not permit operation of

the Equipment other than by [its] employees." In turn, Taxpayer directed Drivers, in details, in performing specific tasks that were assigned.

Taxpayer's documentation demonstrated that it had behavioral control with respect to Drivers. Taxpayer conducted extensive background checks concerning Drivers, including criminal records, credit history, driving records, immigration status, and random drug and alcohol testing. Taxpayer required that Drivers must have and maintain valid CDLs to operate the Equipment. Additionally, Taxpayer required Drivers to go to Taxpayer's facility where Taxpayer assigned Drivers the work. Upon receiving its customers' purchase orders, Taxpayer incorporated the customers' specifications into its own instructions, which was given to Drivers. As a result, Drivers were required to follow only Taxpayer's directions to complete specific tasks.

Taxpayer's documentation also demonstrated that it provided Drivers all the necessary tools, i.e., the Equipment, although Taxpayer did not own the Equipment. Taxpayer's documentation showed that it assigned and instructed Drivers in details what should be done when operating the Equipment. For example, Taxpayer specifically instructed Drivers to drive specific route or routes; where to stop or to add additional gas/fuel; when and how long to drive and in what speed (acceleration/slow-down); as well as sequences/orders and manners (such as driving with loaded or unloaded materials). Taxpayer also instructed Drivers to complete a daily driver report and to complete a daily driving log. If Drivers deviated from Taxpayer's instructions, Taxpayer would not pay.

Taxpayer also had financial control. In addition to furnishing Drivers with the Equipment, Taxpayer paid for all business expenses, including fuel, oil, and maintenance expenses of the Equipment. Drivers did not have a significant investment in Taxpayer's facilities or Equipment they used in performing the services. Additionally, Drivers did not charge Taxpayer a flat rate or on a "time and materials" basis for the job performed; nor did Drivers make a profit or incur a loss. Taxpayer paid Drivers by hour or by the mileage they drove.

Taxpayer's documentation also demonstrated that Taxpayer and Drivers had employee-employer relationship. An employer-employee relationship "exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished." Longmire, 638 N.E.2d, at 897. "Determining an employer-employee relationship exists ultimately is a question of fact." GKN Co. v. Magness, 744 N.E.2d 397, 402 (Ind. 2001). Thus, determining whether Drivers were employees or independent contractors is not made by the agreements of the parties, but by the substance of the relationship – although Taxpayer may argue that Drivers signed the agreements, acknowledging that they were independent contractors and were not eligible for worker's compensation, pension, or health benefits. Specifically, when individuals were searching for work to support their families and a company presented preprinted (standard-form) agreements for the individuals to sign before hiring, those individuals would have either accepted what was presented to them and signed it or walked away empty-handed. Nonetheless, the agreements may show intent of the parties in creating certain relationship. The same agreements demonstrated that Taxpayer intended to maintain an on-going relationship with Drivers until either party provided a written notice to terminate. Furthermore, driving is an essential aspect of Taxpayer's regular business because Taxpayer offers its customers "in-vehicle, automotive testing on public access roads duplicating real-world environments." Without Drivers driving/operating the Equipment per Taxpayer's instructions, Taxpayer will not be able to deliver the services it promised to its customers.

Finally, whether Drivers had full-time employment somewhere else is irrelevant. The Department's Income Tax Information Bulletin 52 (August 2008), 20080827 Ind. Reg. 045080662NRA, outlines the tax withholding requirements from part-time, temporary, or seasonal employees, in relevant part, states:

#### **I. WITHHOLDING OF TAX FROM PART-TIME, TEMPORARY, OR SEASONAL EMPLOYEES**

Withholding agents are required to withhold both state income tax and county tax at the applicable rates stated on the rate schedules, from the income of all employees, **including part-time, temporary, and seasonal employees. The fact that the employee will not earn in excess of the \$1,000 exemption has no bearing on the withholding by the withholding agent. The Internal Revenue Service, which allows an employee to waive withholding for federal tax purposes when the income is not expected to exceed the federal filing requirements and income allowances, has no bearing on the withholding of taxes from the income of employees for Indiana tax purposes. (Emphasis added).**

In conclusion, Drivers were Taxpayer's employees, not independent contractors. Taxpayer thus was required to have withheld state and county income taxes and remitted those taxes to the Department.

#### **FINDING**

Taxpayer's protest is respectfully denied.

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